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Report on the annual tax treaty case law around the globe conference held at Tilburg University, The Netherlands

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CONFERENCE REPORT

Report on the Annual Tax Treaty Case Law Around the Globe Conference Held at Tilburg University, The Netherlands

Laurens W.D. Wijtvliet*

I INTRODUCTION

At the end of the nineteenth century French novelist, poet, and playwright Jules Verne in a series of short stories recounted the adventures of Phileas Fogg and his valet Passepartout during their attempt to circumnavigate the world in eighty days. It was an endeavour that required careful planning, courage, and a healthy dose of optimism and perseverance. One cannot deny the air of heroism that surrounds this undertaking.

Time has not stood still ever since. Borders have now been broken down, barriers have been removed, and technology enables us to traverse the globe in great haste. What has nevertheless remained is the merit of the mathematical precision that the journey undertaken by Fogg so strictly required. It is therefore quite the challenge to analyse, discuss, and debate within the time span of only three days, thirty-nine tax treaty case law cases covering twenty-four jurisdictions, and five continents. That this is not an insurmountable task was once again shown during the fifth edition of the Tax Treaty Case Law around the Globe Conference, which was organized by the European Tax College¹ in cooperation with the Institute for Austrian and International Tax Law.² After a pilot in Tilburg in 2010 and a first full edition in Vienna in 2011, and two more editions alternating between both cities, this year's edition again took place at Tilburg University, The Netherlands, on 22–24 May 2014.³ The main topics discussed at the conference

focused on seven main themes in tax treaty law, which were elucidated by panels of internationally renowned experts in the field of international tax law. Separate sessions were devoted to each of the subjects, starting with tax treaty interpretation and permanent establishment. Business profits and personal independent services were discussed next, followed by an examination of dividends, beneficial ownership, and capital gains. Attention was subsequently shifted to royalties, whereupon the labour income was at the forefront. The penultimate session dealt with other income, avoidance of double taxation and non-discrimination. The conference was concluded by several presentations on the exchange of information, legal protection, and retroactivity.

Participants were invited to exchange their views on the impact of these cases on the interpretation and application of tax treaties applicable in their home countries. The general aim of the conference was not only to exchange knowledge but also to identify lessons learned in other jurisdictions and to assess whether there is a need to amend or adjust existing tax treaties. The conference was chaired by Professor Eric Kemmeren and Dr Daniel Smit. This article briefly highlights some of the main points raised during the conference. For a complete overview of the materials discussed during the conference, the reader is kindly referred to the book with contributions by all speakers, which has been published by International Bureau of Fiscal Documentation (IBFD).⁴

Notes

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¹ See further <http://www.europeantaxcollege.com>.

² See further <http://www.wu.ac.at/taxlaw>.

³ Reports on the previous editions of this conference were previously published in this journal. See, e.g., D.S. Smit and C.A.T. Peters, Report on the 1st Conference on Recent Tax Treaty Case Law, European Tax College, the Netherlands, 39 Intertax 223–228 (2011). Also: Laurens Wijtvliet, Report on the Annual Tax Treaty Case Law Around the Globe Conference held at Tilburg University, the Netherlands, 41 Intertax 168–176 (2013).

⁴ Eric Kemmeren et al. (Eds.), Tax Treaty Case Law around the Globe 2014, International Bureau of Fiscal Documentation (IBFD) 2014.

2 REPORT ON THE CONFERENCE

2.1 Tax Treaty Interpretation and Permanent Establishment

2.1.1 Fishing Vessels, Company Directors, and Ski Instructors

The first topic discussed was the interpretation of tax treaties and the concept of permanent establishments. Professor Adolfo Martín Jiménez from the Universidad de Cádiz set the ball rolling and discussed a case regarding the permanent establishment (hereinafter: PE) of an Estonian fishing company that caught fish in international waters and subsequently sold it to its sole client in Vigo (Spain).⁵ The company systematically used the Vigo harbor to unload the fish. Services from shipping agents and supplies were also received at that place. All activities thus took place within the geographical area of Spain, where the company director who managed the Spanish company accounts and made payments to suppliers likewise resided. Prior to the fish caught entering Spanish waters, contracts with the Spanish client were signed in Estonia.

The fact that the company accounts were managed from and all of the company correspondence was sent to the director's home address led the Spanish tax authorities to deem this address a fixed place of business. Ultimately, the Spanish *Audiencia Nacional* did not uphold this viewpoint and concluded that the director's home cannot be a fixed place of business because no human and material company resources were kept there. What is more, the tax authorities failed to prove the director's involvement in the signing of the contracts at the company headquarters in Estonia, leading the court to conclude that the director could not be considered a dependent agent either.

This interpretation of the PE concept appears to stand in sharp contrast with the case of a ski instructor that was referred to the Italian Supreme Court.⁶ Università Cattolica di Piacenza's professor Guglielmo Maisto unfolded the facts of this case that concerned a Slovenian citizen who acted as a tourist intermediary for a Slovenian ski club. For about three months a year, the ski instructor would have an office in an Italian hotel room from where he conducted various activities for Slovenian tourists such as the performance of reception services, providing accommodation services, and the distribution of ski passes. The Supreme Court observed that the ski instructor

conducted business activities in Italy through a permanent establishment and ruled that the hotel room constituted a place of business in Italy. Maisto did not fail to emphasize the permanency aspect and the recurrent nature of the activities performed by the ski instructor that appear to have been decisive in the court's reasoning.

During the debate that followed these cases, various authors observed how the PE concept appears to become obsolete by the sometimes strict adherence to a single geographical point, and not to a country or jurisdiction as a whole.

2.1.2 The Digital Highway: Servers as Permanent Establishments?

In a time where machines, computers, and even robots are increasingly taking over tasks previously performed by man, the question as to the tax treatment of ICT is not to be sneezed at. Dr Martin Berglund (University of Uppsala) ventured into a detailed account of how the Swedish Supreme Administrative Court relied on the Organization for Economic Co-operation and Development (OECD) Commentary to conclude that permanent establishments can exist even without personnel on site. In the case at hand, a combination of a foreign parent and subsidiary company had decided to combine efforts by jointly exploiting a server in Sweden.⁷ It was agreed that the subsidiary would own the server, whereas the parent was to own the software that was installed and operated on the server. The available server space was rented out to the other group companies. Neither the parent nor the subsidiary would have any employed personnel in Sweden: the server would be supervised by personnel employed abroad. The question first contemplated by the Swedish Board for Advance Tax Ruling and subsequently referred to the Supreme Administrative Court was whether the server would constitute a permanent establishment for either company. The Court followed the OECD Commentaries and held that the essential question in determining whether the server constituted a PE was whether a business is carried on through the fixed place of business. Referring to paragraphs 10 and 42.6 of the Commentary to Article 5, the Court stated that a PE could exist even without any personnel on site. This nevertheless does not mean that no human intervention whatsoever would be required, for the Court did not forbear to emphasize that in the complete absence of personnel a PE would not exist.

Notes

⁵ Spanish National Court, 25 Apr. 2013, 169/2010.

⁶ Supreme Court 17 Jan. 2013, No. 1107.

⁷ Swedish Board for Advance Tax Rulings, 12 Jun. 2013, No. 125-11/D and Supreme Administrative Court 6 Dec. 2013, No. 4890-13.

2.2 Business Profits and Personal Independent Services

2.2.1 Primary and Secondary Adjustments

The second session focused on business profits and income from personal independent services. With regard to the former, transfer pricing is a hot topic nowadays. So, it will be no surprise that a large part of the cases discussed during this session concerned transfer pricing issues.

University of British Columbia professor David Duff unfolded a case that regarded primary and secondary adjustments under the Canada-Luxembourg Treaty.⁸ Contrary to the OECD Model Convention, this tax treaty contains in Article 9(3) a so-called limitation period that forbids Contracting States to include the income that would have accrued had a transaction been conducted under arm's length conditions after expiration of a five year period. In the case at hand, a Canada resident taxpayer had issued the primary transfer pricing adjustment slightly less than five years after the end of the tax year to which it was related. The secondary adjustment – which involved a liability for failing to withhold tax – was issued more than five years after the end of the tax year to which it related. The question arose as to whether this secondary adjustment could still be enforced. The Tax Court interpreted the words of Article 9(3) within their context and in light of their object and purpose and ruled the secondary adjustment not to be subject to the limitation period of Article 9(3), because secondary adjustments 'can never satisfy the requirements' of the provision read in conjunction with Article 9(1).

Professor Duff subscribed to the Court's point of view but acknowledged that the reasoning lacked clarity and persuasiveness stating that the litigious provisions only address adjustments to income that would have accrued to an enterprise, but for conditions made or imposed between associated enterprises and not to taxation in respect of deemed income that has actually accrued to an associated enterprise because of a non-arm's length relationship. Moreover, Professor Duff emphasized, there is no need for a limitation period on secondary adjustments, since tax authorities and taxpayers are on notice about the tax consequences from the primary adjustment.

2.2.2 Profit Sharing, Share Repurchase, and Loss Compensation: The Danish Perspective

Professor Søren Friis Hansen of the Copenhagen Business School reviewed a Danish case that dealt with the arm's

length principle in connection with debt conversion.⁹ The moot point was whether a Danish 'aktieselskab' (public limited company) could deduct the full loss suffered on the conversion of 80% of its claim against a Czech limited company into share capital. After all, the taxpayer reasoned, an independent creditor would have suffered a loss of that size and would have been able to offset it. The tax authorities did not subscribe to this viewpoint and only permitted the deduction of a proportional part of the taxable loss corresponding to the part of the claim that had actually been converted into share capital. The Supreme Court followed the tax authorities and concluded that the taxable loss in relation to the debt claim should be established on the basis of the proportion of the claim that was actually converted into share capital. The Supreme Court did not find this conclusion to violate Denmark's obligation under Article 9 of the Denmark-Czech Tax Treaty.

2.2.3 The Application of Domestic Anti-avoidance Rules: The Czech Perspective

Continuing on the subject of Article 9, Dr Danuše Nerudová from the Mendel University in Brno (Czech Republic) discussed a case that amongst other things dealt with the often disputed application of special domestic anti-avoidance rules (i.e., thin capitalization rules) on a loan from a debtor in the country of the treaty partner.¹⁰ The case concerned the Czech-based company British American Tobacco, s.r.o. (hereinafter: BAT) that had received a loan for the support of its operating activities from the UK resident group company British American Tobacco International Finance (hereinafter: BATIF). Under Czech thin capitalization rules, the interest payments from BAT to BATIF were considered as a share in the profits of BAT, which as a consequence could not be deducted for tax purposes. The Czech Supreme Court found the thin capitalization rules at issue to be incompatible with the Czech-United Kingdom tax treaty, outright rejecting the national thin cap rules in a treaty situation because the tax treaty has precedence over national law.

Apart from the application of special domestic anti-avoidance rules, the Court also addressed the question whether the term 'special relationship' in the tax treaty concluded between the Czech Republic and the United Kingdom could be identified with the term 'associated enterprise' in Czech national income tax. The Supreme Court answered the question in the negative and held that the two terms cannot be identified with each other.

Notes

⁸ Tax Court of Canada 13 Dec. 2013 *McKesson Canada Corp. v. The Queen*, 2013 TCC 404 (TCC).

⁹ Danish Supreme Court 3 Oct. 2013, SKM2013.699HR.

¹⁰ Czech Supreme Court 28 Mar. 2013, 2 Afs 71/2012-87.

Instead – as a rule – specific evidence supporting the special relationship needs to be presented.

In the debate that followed, Professor Alfred Storck of the Institute for Austrian and International Tax Law raised the question whether the CJEU's decisions in the cases *Lankhorst-Hohorst* and *UK Thin Cap* give cause to the introduction of cross-border thin capitalization rules within the European Union. After all, it appears to be implicitly assumed that transfer pricing adjustments are always met with a corresponding adjustment in a strictly domestic situation, whereas this might not be the case in a cross-border setting.

2.2.4 Income from Former Research and Fixed Base: The Netherlands

Dutch case law illustrates that the tax treatment of the income of scientists, inventors, and authors can sometimes be quite a brainteaser. Moreover, such income from intellectual activities need not always necessarily constitute a royalty, as was exemplified by Tilburg University Professor Eric Kemmeren's discussion of a Dutch Supreme Court ruling regarding income from former research.¹¹ The case dealt with the allocation of taxing rights on income from former research under the 1980 Netherlands-United Kingdom tax treaty. The case concerned a taxpayer who had carried out scientific research with the A research institution during the 1990s. A was located in the United Kingdom. For the period of his stay with A, the taxpayer had been granted a scholarship by B. During the period of his research, the taxpayer did not live in the Netherlands, nor was he employed by either A or B.

Before the actual start of the research, the taxpayer had concluded an agreement with A, pursuant to which he surrendered all the potential patent rights that might flow from his research activities to A. A subsequently commercialized the patents and paid the taxpayer on an irregular basis an amount totalling EUR 133.948 which was classified as 'awards to investors'. According to the Dutch tax authorities, the income constituted royalty income, which was to be allocated exclusively to the Netherlands as the state of residence. The taxpayer reasoned otherwise, claiming that the taxing rights were to be allocated to the United Kingdom.

In its ruling, the Supreme Court followed the *Den Bosch* Court of Appeals in claiming that the income was to be classified as 'income from other activities' (*resultaat uit overige werkzaamheden*) under domestic tax law. In this respect, it appears to have been decisive that all potential property rights had already been surrendered to A in

advance and that the amounts paid could therefore never be considered a consideration for the use or the right to use property or rights. Moreover, Article 14(2) of the DTC specifically mentions independent scientific activities as a source of income. The Supreme Court subsequently ruled that the income could not be classified as royalties under Article 12 of the Netherlands – United Kingdom DTC. Instead, the income had to be classified as income from independent services within the meaning of Article 14 of the DTC.

A related question was whether the laboratories of A constituted a fixed base through which the taxpayer had carried out his research. It was further decided that this was indeed the case. Consequently, the taxpayer had conducted his research through a fixed base to which the income had to be attributed.

From the decision, it clearly follows that no fixed base needs to be in place at the time when the income is received. Instead, a causal connection with the fixed base appears to be sufficient to attribute income from prior years to the (former) fixed base. The latter insight appears to be important, as the Dutch Supreme Court followed a comparable reasoning in a case that was addressed later on by Dr Daniel Smit, which will be discussed below.

2.3 Dividends, Beneficial Ownership, and Capital Gains

2.3.1 The Disposal of Real Estate and Dutch Recapture Rules

Dr Daniel Smit (Tilburg University) highlighted a Dutch case that concerned the compatibility of rollover relief provision and recapture rules with the tax treaty concluded between the Netherlands and Luxembourg.¹² Like the case discussed in 2.2.4 above, this case makes clear that – from a Dutch perspective – the timing of a taxable event or of taxable activities and the moment taxes are due need not coincide.

The case concerned a Dutch company that allegedly resided in Luxembourg under the Netherlands-Luxembourg tax treaty. The company had disposed of two pieces of Dutch real estate in 1998 and 1999, respectively, at the same time divesting itself of all its business assets in the Netherlands. Subsequent to the disposals, the company had in both instances formed a reinvestment reserve that provided for a tax deferral on the capital gains realized on the disposal. In 2001, the taxpayer's intention to reinvest expired, triggering the recapture of the reinvestment reserve. The question then was whether the Netherlands were still allowed to apply the recapture rule

Notes

¹¹ Dutch Supreme Court 6 Dec. 2013, nr. 12/00252, BNB 2014/38.

¹² Dutch Supreme Court 22 Mar. 2013, nr. 11/05599, BNB 2013/114.

and tax the 1998 and 1999 capital gains under the Netherlands-Luxembourg tax treaty, or whether this constituted treaty override. Moreover, the dispute regarded the year in which the taxable gains were to be reported.

The Dutch Supreme Court reasoned that Dutch exit tax rules could not be applied in 1999 since the taxpayer could not be said to have ceased to generate taxable profits in the Netherlands after the disposal of the real estate. Hence, no corporate income tax was due in 1999. However, since the taxpayer no longer had the intention to reinvest in 2001, domestic law rightfully triggered the recapture of the rollover relief provided by the reinvestment reserve. According to the Supreme Court, this recapture did not constitute a tax treaty override because the Netherlands-Luxembourg tax treaty does not prevent the taxation of capital gains in a later year than the year in which the real estate was actually disposed of.

The main observation made by Dr Smit was that there thus appears to be a fundamental difference between the termination or liquidation of activities and the formation of a reinvestment reserve. He further noted that it does not appear to be relevant whether taxation is due in another year than that in which the real estate was disposed of. Dr Smit further raised the question whether a similar territoriality-based approach could or – maybe even – should be applied under Article 7 of the OECD Model Convention. In Smit's view, this would mean that each contracting state would be entitled to tax (un)realized gains to the extent that such gains have accrued in their territory, irrespective of the place of residence of the taxpayer once the income is actually paid. Such an approach would – according to Smit – not only be in line with the benefit principle, but also enhance global corporate mobility and respect governments' tax claims. Moreover, exit taxes would thus be superfluous and a thing of the past.

2.3.2 Exit Taxes under the Franco-Switzerland Treaty

Timing, exit taxes, and treaty override were also the key ingredients to the case of Mr Picart that was discussed by Professor Dr Alexandre Maitrot de la Motte of the Université Paris-Est Créteil.¹³ Mr Picart was a French resident who transferred his tax residence to Switzerland in 2002. Under the French general tax code (as it applied in 2002), taxpayers who had been domiciled in France for at least six of the last ten years were taxable, at the date of transfer of their residence outside France, on the unrealized gains on – amongst other things – their share holdings.

Mr Picart objected to the imposition of this exit tax, invoking Article 15(5) of the 1966 Franco-Swiss Tax Treaty that allocates the right to tax capital gains related to shares and securities to the state of residence (*in casu* Switzerland).

The Conseil d'Etat struck down Mr Pickart's reasoning, observing that under French domestic law the exit taxes were due before – and not after – the transfer of residence. At that moment, Mr Pickart was still a French tax resident, leading the Court to conclude that the exit tax was not incompatible with Article 15(5) of the 1966 Franco-Swiss Tax Treaty.

Commenting on the outcome of the case, Professor De la Motte observed that the resident article of the Franco-Swiss Tax Treaty contains a specific provision that deems an individual who has definitively transferred his domicile from one Contracting State to the other to be subject to tax in the state of departure only at the expiry of the day on which the residence is transferred. Another interesting point was made by Professor Michael Lang of the Institute of Austrian and International Tax Law that the key issue of this case should have been the exact interpretation of the term 'alienation'. In Lang's view, alienation implies a change in ownership, which definitely did not take place in the case at hand. According to Lang, the case should then involve the 'other income' Article, and not the capital gains provisions.

2.3.3 The Interpretation and Meaning of a Dividend Paid

Making his second appearance of the day, Professor Maisto discussed a case that concerned the interpretation of the words 'dividends paid by a company' in Article 10 of the Italy-United Kingdom DTC.¹⁴ This treaty used to contain a provision that grants UK shareholders the right to obtain from the Italian Treasury a portion of the dividend tax credit that would have been granted had the shareholder been an Italian resident. The entitlement to this credit arises under the treaty when dividends are 'paid' to a UK resident.¹⁵

In the case at hand an Italian subsidiary had distributed a dividend to its UK parent. The dividend was never actually paid out. Instead, it was converted into an interest-bearing loan from the parent back to the subsidiary. The UK parent argued that because the dividend had been declared it had constituted a receivable, which was then converted into a loan. In the taxpayer's opinion, it could therefore be concluded that the dividend

Notes

¹³ Conseil d'Etat 29 Apr. 2013, 357576, Mr Picart.

¹⁴ Supreme Court 20 Feb. 2013, No. 4164.

¹⁵ It should be noted that the litigious provision was removed from the treaty later on. Nevertheless, the meaning of the terms 'paid' or 'payment' discussed by the court may still be relevant for Art. 10 and other treaty provisions.

had first been 'paid' to the parent company and subsequently been lent to the subsidiary, regardless the fact that the series of transactions did not constitute a cash transfer.

The Supreme Court refused to uphold the taxpayer's reasoning, denying the tax credit because the special credit provision was only to apply when the dividend was materially paid. According to the Court, this condition is not met if the obligation to pay the dividend is converted into a loan. Moreover, the Court held that the UK parent company could not be regarded as the beneficial owner of the dividend. Finally, a certificate issued by the British Tax Authorities generally stating that the UK parent was subject to UK corporate income tax proved insufficient to obtain the credit.

2.3.4 Proof of Residence and Treaty Benefits

In order to receive specific treaty benefits, more than just proof of taxpayer residence in a treaty jurisdiction may be required, as was apparent from the case discussed by César A Domínguez Crespo (Universidad de Guanajuato, Mexico).¹⁶ In the case at hand, a Mexican corporate taxpayer was refused deduction of payments made under two contracts as a consequence of incorrect classification of the payment and for failing to prove to be a US resident respectively. In a ruling that synthesizes a series of criteria that must be met in order for a tax treaty to apply, the Court underscored the importance of formal requirements and administrative regulations to enjoy the benefits of a tax treaty. The Court upheld that the proof of residence is subject to internal formal requirements – such as deadlines or dates of expeditions – and not only to those set out by the tax treaty.

2.4 Royalties

2.4.1 Beneficial Ownership

The conference's fourth session was dedicated entirely to the subject of royalties. Professor Thomas Balco of the KIMEP University of Almaty, Kazakhstan explained the *Oriflame Case*.¹⁷ The case involved payments for the use of a trademark that was ultimately owned by a Luxembourg corporation. The Luxembourg parent company used a Netherlands based subsidiary company to sublicense to the Kazakh company, a trademark that it ultimately owned itself. Thus, royalties were paid by the Kazakh company to

the Dutch company, which in turn paid a royalty to the Luxembourg parent.

Kazakh domestic law provides for a 20% withholding tax on royalty payments. A reduced rate can apply under the Kazakhstan-Netherlands Tax Treaty on the condition that the recipient of the royalty is the beneficial owner to the royalty and resides in a jurisdiction covered by the tax treaty. No tax treaty has been concluded between Kazakhstan and Luxembourg.

The case went through a total of three instances before being brought before the Supreme Court. On all occasions, it was decided that the Dutch sub-licensor could not be considered the beneficial owner of the royalty, because the trademark was ultimately owned by the Luxembourg company. Although the outcome of the case may seem to make sense, Professor Balco did not refrain from criticizing the case for lack of detailed investigation into the roles and functions performed by the Dutch subsidiary on the courts' behalf. It was further noted by Professor Eric Kemmeren that beneficial ownership is in essence not connected with the ownership of – for instance – a trademark. Rather, the concept is related to income. According to Kemmeren it should therefore have been determined who is the beneficial owner of the royalties, regardless of who ultimately owns the trademark.

2.4.2 Recharacterization of Payments: The Spanish Case of Coca-Cola

Next, Professor Adolfo Martín Jiménez discussed a Spanish case that was about the breakdown of a payment into various components, such as royalties.¹⁸ The facts of the case can be summarized as follows. An independent Spanish distributor of Coca-Cola products purchased concentrate for soft drinks from companies of the Coca-Cola Group. It further packaged and sold the soft drinks in Spain. The Spanish distributor considered the payments to the Coca-Cola Group only as payments for the purchase of merchandise. Moreover, the taxpayer emphasized, the contracts concluded with the Coca-Cola companies were not contracts between associated parties, and the right to exploit the trademark was limited to the commercialization of the soft drink in Spain only. Apart from that, the tax authorities would not be allowed to illegally use secret comparables. Therefore, in his view, the payments were not subject to tax in Spain. The Spanish tax administration challenged this view, claiming that the payments were for both the purchase of goods and the use of the Coca-Cola brand. Thus, part of the payment was

Notes

¹⁶ First Section of the High Chamber of the Mexican Administrative Court, 15th Nov. 2012 (compulsory after publication in February 2013), case 14409/11.

¹⁷ Kazakhstan Supreme Court 3-215/2013.

¹⁸ Spanish Administrative Central Court of 30 Oct. 2013.

indeed to be considered royalties subject to withholding tax at source.

The Spanish Supreme Administrative Central Court ruled that the Spanish tax administration could in fact make use of the powers granted by domestic law to characterize the transaction both parties had entered into according to their true legal nature, regardless of the enterprises being unrelated. In doing so, the court relied on paragraph 11.6 of the Commentaries to Article 12 of the OECD Model Convention and on paragraph 6.17 of the OECD TP Guidelines to disaggregate the agreement and split it into a payment for the use of the trademark (royalty) and a payment for the concentrates. However, the Court concluded that Spanish law did not permit the use of secret comparables for the determination of the part of the price that was to be considered a royalty.

Jiménez found it very peculiar that the Court paid attention to the meaning and interpretation of the term ‘use’ in Article 12 of the OECD Model Treaty. The Court’s flawed approach could very well create uncertainty since the Commentary on Article 12 clearly states that the payments for distribution rights themselves do not give rise to royalties. From the decision, it does not follow when a distributor that does more than just distributing goods is considered to be paying a royalty.

2.4.3 The Concept of Royalties: Some Indian Perspectives

The session on royalties was concluded by an elaboration of three Indian cases presented by DP Sengupta. All of these cases dealt with the definition, interpretation, and classification of a payment as a royalty.

The first case concerned a local Indian florist who advertised his business through the Google and Yahoo search engines.¹⁹ His advertisements were displayed when a search executed using the search engines contained certain key words. In return for services rendered, the Indian taxpayer made payments to Google Ireland and Yahoo US. The Indian tax authorities refused deduction of these payments, arguing that taxes should have been withheld at source. From the decision rendered, it is clear that in the case at hand a website per se could not constitute a permanent establishment in India for the search engine companies. Moreover, relying on the OECD Model Convention and its Commentaries, the Kolkata Tribunal held that a search engine could not have a permanent establishment in India through its website, unless its servers are also located within Indian territory,

which did not appear to be the case. Since in the case at hand the florist had no right to use any industrial, commercial, or scientific equipment whatsoever, the payments could be considered a royalty under domestic law.

The second case regarded *Verizon Communication Singapore Pte Ltd* that was engaged in the business of providing international private leased circuits (IPLC), which is basically a private connection between various (Indian and overseas) offices of a client.²⁰ Payments for the (right to) use an IPLC were found to constitute a royalty under the India-Singapore Double Tax Treaty by both the tax tribunal and the Madras High Court. The High Court also emphasized that even if the payment is not treated as one for the use of the equipment, it should still be considered a payment for the use of the process that was provided by Verizon. This process consisted of the assurance of bandwidth for a guaranteed transmission of data and voice. Thus, not only a royalty for the use of the equipment could be discerned, but also another royalty that could be allocated to the use of the process.

The final case of this session dealt with the question of whether a fee paid for the testing of circuit breakers constituted ‘fees for technical services’ under the India-Germany double tax treaty.²¹ The Mumbai Tribunal held that the expression ‘fees for technical services’ has been defined as a consideration for rendering managerial, technical or consultancy services. The word technical being positioned right in the middle between ‘managerial’ and ‘consultancy’ means that it cannot be considered in isolation but must be read in conjunction with both terms. This is the so-called principle of *noscitur a sociis*, which dictates that the meaning of a word or expression is to be gathered from the surrounding words or context. Since managerial and consultancy services can only be provided by humans only, according to the Court the word technical has to be construed in the same sense involving direct human involvement. Consequently, if only equipment or machines are employed, the activity cannot be considered the provision of technical services.

2.5 Labour Income

2.5.1 The Definition of Employer: The Austria-Slovakia Treaty

In an Austrian case presented by Kasper Dziurdz of the Institute for Austrian and International Tax Law, WU (Vienna University of Economics and Business), an

Notes

¹⁹ Kolkata Tribunal 12 Apr. 2013, Right Florist Pvt Ltd: 2013-TII-ITAT-KOL-INTL.

²⁰ Madras High Court decision, 7 Nov. 2013, Verizon Communications Singapore Pte Ltd: 2013-TII-48-HC-MAD-INTL.

²¹ Mumbai Tribunal decision, 12 Feb. 2013, Siemens Ltd: 2013-TII-34-ITAT-MUM-INTL.

Austrian parent company had seconded an employee resident in Austria to a Slovak subsidiary.²² The secondment lasted for not more than 183 days and the employee was required to work for the Slovak subsidiary only 30% of his working time. The employee was integrated into the business of the subsidiary, that not only supervised his work and bore responsibility for the output, but also ran all the risks connected with the work. Moreover, the subsidiary determined the working hours and provided working materials and office space. However, the contract remained with the Austrian parent company, which negotiated the salary, determined the holidays, and was responsible for all social security measures, severance payments, and had the right to impose disciplinary sanctions and to terminate the contract. As a contribution towards the costs, the Austrian company charged 30% of the salary to the Slovak subsidiary without any markup, from which it can be inferred that the subsidiary to this amount bore the risk of payment in the event of non-performance.

Under Austrian domestic law, which provides for a rather formal meaning of the term ‘employer’, the Austrian company remained the employer. However, for treaty purposes, this was different. The Supreme Administrative Court emphasized that Article 3(2) of the Austria-Slovakia Tax Treaty refers to the domestic meaning of ‘employer’ if the context does not otherwise require. Under the applicable treaty, the court found, the context requires an autonomous interpretation of the term ‘employer’ in Article 15(2). Based on the object and purpose of this provision and in the light of who had economically borne the remuneration, the Supreme Administrative Court concluded that the Slovak company had to be considered employer for tax treaty purposes.

2.5.2 Employment Stock Options and the OECD Commentaries

Professor Marjaana Helminen of the University of Helsinki marked a turning point in the tax treatment of employee stock options. The case she discussed is a prime example of how closely Finnish Courts nowadays try to comply with OECD recommendations.²³ Prior to the ruling in the case discussed, the Finnish Supreme Administrative Court had always considered the entire period between the grant and the exercise of an option relevant. Now the Court has apparently changed its

interpretation by referring directly to the Commentary on Article 15 of the OECD Model Convention. According to paragraph 12.6 of this Commentary, the end of the vesting period – and not the moment the option is exercised – should be relevant for tax purposes. In its decision, the Court thus did an about-turn by adhering to the OECD recommendation once again and considering the end of the vesting period.

2.5.3 The Demarcation between Service Income and Royalties: The García Case (USA)

This fifth session, on labour income, also clearly highlighted the importance of properly distinguishing between royalties and service income. University of Florida, Levin College of Law Professor Yariv Brauner once again showed that this distinction is not that easily drawn and is far from clear in practice.²⁴ The case concerned the Spanish professional golfer Sergio García, who resides in Switzerland.²⁵ As a professional golfer, García had entered into endorsement agreements with sponsors. Before the US Tax Court, the question was how these payments received for royalties and personal services were to be allocated under the Switzerland-United States Tax Treaty. The US Tax Court held that the compensation received as royalties was exempted from US income tax, but that the compensation received for personal services was not. The Court rejected a distributive formula included in the agreement, which allocated 85% of the payments to royalties and 15% to personal services and set aside various allocations proposed by expert parties. Instead, the Court concluded that – based on the evidence presented – 65% of the payments under the agreement represented royalties and 35% were for personal services.

2.6 Other Income, Avoidance of Double Taxation, and Non-discrimination

2.6.1 Fictitious Income under the Nordic Tax Treaty

During the penultimate session, on other income, the avoidance of double taxation and non-discrimination, a wide variety of topics was addressed. Making another appearance, Dr Martin Berglund outlined the interpretation and treatment of fictitious income computed on the basis of the value of assets in a pool of

Notes

²² Austrian Supreme Administrative Court 22 May 2013, No. 2009/13/0031.

²³ Finnish Supreme Administrative Court 16 May 2013, KHO 2013/1704(93).

²⁴ During the 2012 Conference, Professor Brauner made similar observation. For a discussion of the case Professor Brauner discussed at that time, see Laurens Wijnvliet, Report on the Annual Tax Treaty Case Law Around the Globe Conference held at Tilburg University, the Netherlands, Intertax 41-3 (2013), s. 2.5.2 (p. 174).

²⁵ *Sergio García v. Commissioner of Internal Revenue*, 140 T.C. No. 6 (2013).

shares under the Nordic tax treaty.²⁶ The case concerned a Danish taxpayer who wished to place his assets in a special Swedish box regime for investment assets and to own shares in various investment funds. A characteristic feature of the box regime is that the actual yield of the investment is not taxed. Instead, a fictitious income based on the assets' total value is computed annually. Before the Court, the dispute was bipartite. At stake was not only whether the fictitious income in question could be considered income under the Nordic tax treaty, but also, if so, which allocation rule would apply.

In deciding the case, the Court compared the fictitious income from the box regime with previous case law and observed that the fictitious income from the box regime and the investment funds were calculated in order to correspond to the anticipated yield of the assets in question. According to the Court, these types of fictitious income did not compare to fictitious income on deferred capital gains. Instead, Article 22 (other income) of the Nordic treaty applied, depriving Sweden of its right to tax income as a source state.

2.6.2 The Interpretation of the Foreign Tax Credit Clause of the Belgium-US Treaty

Professor Luc De Broe (KU Leuven) subsequently brought into the limelight a case that concerned the interpretation of the foreign tax credit clause of the Belgium-United States tax treaty. More precisely, the case dealt with the tenability of the Belgian (former) tax credit regime, which had changed over time. At the time the treaty was concluded in 1970, Belgian domestic rules provided for a lump sum foreign tax credit for foreign interest net of tax, regardless of the amount of foreign tax that was actually paid. In 1991, the lump sum was abolished and replaced by a credit for the foreign tax actually paid. Later, in 1994, the foreign tax credit was reduced by the debt-financing ratio of the taxpayer. The taxpayer argued that the application of the debt-financing ratio affected the lump sum nature of the credit and cannot reduce the amount of the credit because posterior changes in domestic law have to be disregarded for the purposes of Article 23 of the treaty. The Supreme Court struck down the taxpayer's position, concluding that the debt-financing ratio does not infringe Article 23 of the DTC. Instead – the Court held – it merely modifies the method of calculating the credit.

Article 23(3)(b) was thus found not to prevent the application of the domestic debt financing ratio.

2.6.3 Arbitration

Dr João Nogueira (IBFD) discussed an arbitration case that concerned the application of the non-discrimination provision of the Portugal-Brazil treaty to cases where the tax treatment of a permanent establishment and a 'comparable' subsidiary deviates.²⁷ The facts of the case can be summarized as follows. The Brazilian resident company A operated its business through a PE in Portugal. The PE received dividends from various Portuguese companies. Although not provided for in domestic law, A directly applied the domestic regime for the relief of economic double taxation to the dividends received that basically applies to certain companies (not PEs!) only, invoking the non-discrimination clause of Article 24(3) of the Portugal-Brazil DTC and arguing that tax relief is applicable *ex vi* this provision.

The Court observed that – to the letter of the domestic law – the PE could not claim tax relief. However, the Court found the PE of the Brazilian company comparable to a Portuguese company, leading it to apply the non-discrimination provision and to rule the different treatment of a Portuguese company and a PE of a foreign head office to be inadmissible. In deciding accordingly, the court based its decision solely on the wording of the treaty: it refrained from making reference to existing – foreign and domestic – case law and failed to invoke to Commentaries to the OECD Model Convention.

During the debate that ensued after Dr Nogueira's presentation, Professor Vanistendael (KU Leuven) interestingly observed that the Portuguese arbitration Court appears to have taken a rather unique approach by applying Article 24 analogous to the fundamental European freedoms. In Vanistendael's view, the Court's approach could very well signal a new line of reasoning about the application of this Article.

2.6.4 Russia: The Thin Cap Saga Continues

Thincap appears to dominate Russian tax case law. Having discussed the cases of *Severny Kuzbass*²⁸ and *NaryanmarNefteGas*²⁹ – which both regard thin

Notes

²⁶ Supreme Administrative Court 6 Jun. 2013, HFD 2013 ref. 23. It should be noted that in 2012 the Supreme Administrative Court had already decided that fictitious income based on amounts of tax deferrals on capital gains was not covered by the Nordic tax treaty. See HFD 2012 ref. 60.

²⁷ Arbitration 26 Nov. 2013, 154/2013-T.

²⁸ Supreme Commercial Court, 15 Nov. 2011, *Severny Kuzbass*, no. 8654/11. This case was discussed in the report on the 2012 conference. See Laurens Wijnvliet, Report on the Annual Tax Treaty Case Law Around the Globe Conference held at Tilburg University, the Netherlands, Intertax 41-3 (2013), pp. 175–176.

²⁹ Russian Supreme Commercial Court 21 Jun. 2012, *NaryanmarNefteGas v. Russian Federation*, No. VAS-7104/12.

capitalization rules – in 2012 and 2013 respectively, Professor Danil Vinnitskiy of the Ural State University of Law this time elucidated the case of *United Bakers Pskov LLC/ Kellogg Group*.³⁰ This case concerned the interaction between Russian domestic legislation and the clauses of tax treaties entered into by the Russian Federation. In this case, the Russian based taxpayer United-Bakers Pskov LLC had received a loan from a Luxembourg sister company. Both companies were ultimately controlled by Bermuda-registered Kellogg Europe Company Ltd. Russian domestic law provides for thin capitalization rules that amongst other things apply to situations where a Russian company has an outstanding debt to a non-resident company (a) which directly or indirectly holds or controls more than 20% of the share capital in the Russian company, or (b) if a Russian company has an outstanding debt to a Russian company recognized under the law of the Russian Federation as affiliated to the above-mentioned non-resident company. As a consequence, Russian thin capitalization rules do not apply to Russian companies owned by other Russian residents and/or debt that is not controlled by a foreign company. This differential treatment was a thorn in the taxpayer's side. Nevertheless, his hopes turned out to be vain, because after interpreting Articles 9 and 24 of the Russia-Luxembourg tax treaty, the Court concluded that there were in fact grounds for the application of Russian thin capitalization rules to a non-arm's length loan issued by a sister company.

2.7 Exchange of Information, Legal Protection, and Retroactivity

In the era of BEPS, the importance of exchange of information is growing rapidly. This raises various questions and issues with regard to legal protection of taxpayers and the nature of the procedures followed to obtain relevant information about the taxpayer. The conference was therefore concluded with a session on this topic, which on occasion proved to be one of major controversy. Out of the presentations covered under this heading, the difference in treatment by the requesting and the requested state respectively stood out.

2.7.1 Fishing Expeditions

Stefano Bernasconi discussed the Credit Suisse II case which dealt with group requests under Article 26 of the

Switzerland – United States DTC. This provision allows for the exchange of information to prevent 'tax fraud or the like' without mentioning the name of a specific person.³¹ In the case at hand, it was disputed whether group requests were also covered by this provision, especially when the requests are based on a number of rather broad selection criteria, without reference to the name of the taxpayers. The Swiss Federal Court ruled that group requests for mutual assistance are also covered by the Switzerland – United States DTC – whether those persons are explicitly named or not. In fact, the description of the facts and their detail as to provide reasonable grounds for the suspicion of fraud and the like and to enable the identification of the taxpayer turned out to be more important. It is up to the requesting state to present these facts and to substantiate that 'tax fraud or the like' take place at a specific bank. Fishing expeditions, the court stated, nevertheless remain forbidden.

A comparable outcome was reached in the case discussed by Professor Martin Wenz of the University of Liechtenstein in Vaduz.³² From this case – which dealt with the exchange of information under the Tax Information Exchange Agreement concluded between Liechtenstein and Germany – it followed that beneficiaries need not be fully named, but specific attributes (e.g., address or domicile) must be included in the request to facilitate identification of the taxpayers. Moreover, the assumption or likelihood that some taxpayers or beneficiaries might be German proved insufficient to identify relevant taxpayers.

In contrast, Professor Werner Haslehner of the University of Luxembourg illustrated how the lack of a name of a specific taxpayer led the Luxembourg Cour Administrative to deny a request for information.³³ Although the request issued by the French tax authorities included a bank account number, the Luxembourg Court of Appeals considered the whole to be a fishing expedition because no concrete taxpayer was named. In deciding so, the court relied on the wording of the OECD Commentary and the Manual on Tax Information Exchange.

2.7.2 Taxpayer Rights

A number of cases discussed during the final session of the conference were about the rights of taxpayers or parties related to them to be informed about them being the subject of investigations.

Discussing a Portuguese case, IBFD's João Nogueira showed that taxpayers need not always be informed in

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³⁰ Russian Federal Commercial Court of the North-West Region 18 Sep. 2013, No. A52-4072/2012.

³¹ Federal Supreme Court 5 Jul. 2013, Credit Suisse BGE 139 II 404.

³² Constitutional Court 3 Sep. 2012, 2012/106.

³³ Cour Administrative 24 Sep. 2013, CA 33118C.

advance about their being the subject of an audit in the requested state.³⁴ The case concerned a Portuguese taxpayer from whom information regarding one of its subsidiaries was required. The internal procedure to obtain such information was considered a tax proceeding, as a consequence of which the taxpayer only has a right to be notified of the remission of the requested information about him to the tax authorities of the requesting state. The taxpayer need not be informed about any intermediary acts of the proceedings, nor is he entitled to know the context of the information exchanged. In deciding this case, the Portuguese court invoked the CJEU's *Sabou* case that was delivered only one day before.³⁵

This case appears to contrast with a Luxembourg case that was discussed by Professor Werner Haslehner. In this case, the Luxembourg Court of Appeals denied exceptions in the OECD Commentary to Article 26 that would allow the Luxembourg tax authorities to keep the content of an

information request confidential and prevent them from disclosing its contents to the taxpayer.³⁶

3 FINAL REMARKS

Tax treaties are by their very nature an international phenomenon. Traditionally they have dealt with issues of international double taxation that may arise in cross-border situations and transactions. In an ever globalizing world, it is important to monitor the relevant developments in this field and to learn from each other about the interpretation and application of such treaties, the ideal being the creation of one common approach. The journey around the world that was undertaken in Tilburg was thus a more than welcome approach. This is obviously a long journey that can only be taken one step at a time. The cases discussed at the conference can provide direction to where we are going and can be considered a valuable contribution to this end.

Notes

³⁴ Supreme Administrative Court 23 Oct. 2013, 01361/13.

³⁵ Court of Justice of the European Union 22 Oct. 2013, Case C-276/12 (*Sabou*).

³⁶ Cour Administrative 2 May 2013, CA 32184C.

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